

NEW RULES ON “ACTING IN CONCERT” CONCERNING LISTED GERMAN COMPANIES: SCOPE OF POTENTIAL APPLICATION EXTENDED

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I. INTRODUCTION

The so-called “Risk Limitation Act” (the “Act”) has been finally adopted and its major sections entered into force on August 19, 2008.

Of particular practical relevance are the modified provisions of coordinated conduct between investors concerning attribution of voting rights, the so-called *acting in concert* provision of Section 22(2) of the German Securities Trading Act (“WpHG”) and Section 30(2) of the German Act on the Acquisition of Securities and on Takeovers (“WpÜG”). Such coordinated conduct between investors may lead to a **mutual attribution** of the respective voting rights for purposes of notification obligations and – more importantly – the determination that such investors are gaining control possibly resulting in an **obligation to make a mandatory bid** for the outstanding share capital of a target company. For example, if Shareholder A holds (or is deemed to hold due to the attribution rules) 20% of the voting rights and Shareholder B holds (or is deemed to hold) 10% of the voting rights in the same issuer/target company and A and B are regarded to coordinate their conduct in accordance within the rules on *acting in concert*, their total shareholdings would be aggregated for the purposes of determining their relevant stakes in the company concerned. Here, both A and B would each be treated as holding 30% of the voting rights (which is regarded as a controlling stake) of the issuer/target company.

The failure to submit a notification in accordance with Sections 21 *et seq.* of the German Securities Trading Act or the failure to submit a mandatory bid may result in the **loss of rights** arising from the shares and lead to **regulatory fines**. Due to the uncertainties in connection with the definition of *acting in concert*, it may in some cases also be unclear whether or not certain shareholders are entitled to exercise their voting rights at a shareholders’ meeting. If voting rights are exercised in such a situation, it may lead to **legal challenges of resolutions** passed at the shareholders’ meeting.

II. PREVIOUS WORDING AND STRICT INTERPRETATION BY THE GERMAN SUPREME COURT

The previous version of Section 22(2) of the German Securities Trading Act provided that a person subject to disclosure requirements may be attributed the voting rights of a third party’s shares of a German issuer when this person or its subsidiary *coordinates its behavior concerning the issuer on the basis of an agreement or by other means* with the third party. This did not include agreements on the exercising of voting rights in *individual cases*. Section 30(2) of the German Act on the Acquisition of Securities and on Takeovers contained a virtually identical wording with regard to takeover law.

In 2006, the German Supreme Court clarified that *acting in concert* was only given, when the parties' **coordination was**

(i) conducted with respect to the exercising of voting rights in the shareholders' meeting of the issuer/target company,

(ii) not exclusively limited to an individual case and

(iii) intended to (permanently and extensively) modify corporate strategy.

Thus, Sections 22(2) of the German Securities Trading Act and 30(2) of the German Act on the Acquisition of Securities and on Takeovers only encompassed coordinated conduct in connection with exercising voting rights in shareholders' meetings.

III. NEW WORDING OF ATTRIBUTION PROVISIONS

According to the new wording of the attribution provisions, *acting in concert* shall no longer be limited to **coordination** exclusively directed at exercising voting rights in the shareholders' meeting. Coordination will be deemed to include instances when coordination **is conducted with the purpose of a permanent and extensive modification of the corporate strategy (*unternehmerische Ausrichtung*) of the issuer/target company.**

The exception for coordination **in individual instances** has been retained.

IV. CONSEQUENCES: CASES UNCHANGED BY REVISION

The *acting in concert* provisions **continue to apply to** coordination with respect to the exercising of voting rights in the shareholders' meeting, for example through the **conclusion of voting trusts or pooling agreements**, regardless of the purpose of the coordination. However, the coordination must be ongoing and not merely limited to an individual case.

The following actions do not constitute *acting in concert*, either prior to or following the adoption of the Act:

- **Parallel, coordinated acquisition of shareholdings** without further objectives concerning the issuer/target company.
- **Strictly internal supervisory board matters.** The German Supreme Court has confirmed in this respect that members of the supervisory board are exclusively committed to the interests of the company and are not subject to any binding directives that may interfere with their official func-

tions. Therefore, they cannot merely be considered representatives of certain shareholders and are not likely to exercise any relevant coordinated conduct.

- **Standstill Agreements**, reciprocal **rights of first refusal** and Put or Call **Options**.

V. POTENTIAL EXTENSION TO COORDINATED INFLUENCE ON BOARD MEMBERS

The Act partially extends the scope of *acting in concert* to cover **coordinated exercise of influence on the management board and/or the supervisory board** in order to implement certain objectives, with the purpose of permanently and extensively modifying the corporate strategy of the respective company.

When the German Federal Parliament enacted the amended wording, the legislature apparently had the The Children's Investment Fund ("TCI")/Deutsche Börse AG case in mind. In 2005, after hedge funds spearheaded by TCI intervened, Deutsche Börse had to abandon its plans for a merger with the London Stock Exchange, and the CEO and the chairman of the supervisory board of Deutsche Börse resigned. However, following the failed merger, the Federal Financial Supervisory Authority (BaFin) led an investigation, but was not able to prove that the shareholders coordinated their activities in a way that would have triggered the obligation to submit a mandatory bid to the other shareholders of Deutsche Börse. Since the activities concerning Deutsche Börse did not relate to the exercise of voting rights, there was no objective basis to apply the rules on *acting in concert*.

The new Act makes differentiating between relevant and non-relevant coordinated conduct more difficult, because the extended definition of *acting in concert* is no longer limited to the exercise of voting rights. In particular, it will depend upon the specific facts and circumstances to determine whether exercise of influence goes beyond an *individual case* and represents cooperation with the purpose of *permanently and extensively modifying the corporate strategy* of the issuer or target company. Until these terms are more precisely defined by case law, a significant uncertainty will continue to exist.

To determine whether a change of the corporate strategy is intended, it must be analyzed in two steps: The first step examines the strategic goals and objectives the board has pursued thus far. The second step examines whether the shareholders intend to permanently and extensively "change" certain elements of the corporate strategy or merely wish to amend minor aspects of it and are generally in favor of maintaining the current general strategy.

Even under the new rules, the board is free to enter into open discussions with shareholders if it is still undecided about certain elements of the future strategy and the direction of the company's business, without triggering the *acting in concert* provisions. In such a case, the board is deemed not to have developed a "corporate strategy" yet that may be subject to intended modifications by shareholders. Furthermore, shareholders may freely cooperate to back the board's position with regard to strategic issues, as such approach would constitute a continuation rather than a "change" in corporate strategy.

In cases of intended changes, coordinated conduct may still not fall within the scope of the new *acting in concert* provisions due to the retained exception for coordinated conduct in "individual cases". Thus, even an effort to substantially influence the corporate strategy – as in the TCI/Deutsche Börse case – may be regarded as an (exempt) individual case. The German Federal Supreme Court showed a tendency to make this determination on a very formalistic basis in the past. Accordingly, the further development of case law should be monitored closely.

In any event, mutual or otherwise coordinated conduct by investors should be carefully analyzed in the future in order to minimize potential risks and avoid possible legal issues.

In addition, companies subject to the new rules should inform the relevant internal divisions and officers about the new provisions to identify *acting in concert* at an early stage – e.g., by creating an "*acting in concert* manual" – and, if and when it is in their interest, also protect its shareholders against consequences of such coordinated conduct.

VI. LIMITATION TO "NEW CASES"

The extended definition for *acting in concert* takes effect immediately. However existing cases (*Altfälle*) were excluded from the legal consequences of the Act. Parties engaged in such coordinated conduct that would trigger the revised "*acting in concert*" criteria before the Act applied should clarify that such conduct no longer existed at the time the Act entered into force.

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